



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
ARLINGTON, VIRGINIA 22202-4704

December 4, 2003

**MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL  
MANAGEMENT AND COMPTROLLER)**

**SUBJECT: Independent Auditor's Report on the Air Force General Funds Fiscal Year 2003  
Principal Financial Statements (Report No. D-2004-026)**

The Chief Financial Officers Act of 1990, as amended, requires the Inspector General of the Department of Defense to audit the accompanying Consolidated Balance Sheet of the Air Force General Funds as of September 30, 2003 and 2002, the related Consolidated Statements of Net Cost and Changes in Net Position, and the Combined Statements of Financing<sup>1</sup> and Budgetary Resources for the fiscal years then ended. These financial statements are the responsibility of Air Force management. The Air Force is also responsible for implementing effective internal control and for complying with laws and regulations. We are including the required reports on internal control and compliance with laws and regulations.

**Disclaimer of Opinion on the Financial Statements**

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged that the Air Force previously identified material weaknesses in internal control and instances of noncompliance with laws and regulations that continue to affect the current period. As a result of those conditions, management acknowledged that the financial data reported in the financial statements were unreliable. Therefore, we did not perform auditing procedures to support material amounts on the financial statements. In addition, other auditing procedures were not performed because Section 1008(d) of the FY 2002 National Defense Authorization Act requires the Inspector General of the Department of Defense to perform only the audit procedures required by generally accepted government auditing standards that are consistent with the representations made by management. These material deficiencies also affect the reliability of certain other information contained in the accompanying Management's Discussion and Analysis and certain other information—much of which is taken from the same data sources as the principal financial statements.<sup>2</sup> These deficiencies would have precluded an

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<sup>1</sup> The Office of Management and Budget requires a Consolidated Statement of Financing, instead of the Combined Statement of Financing prepared by the Air Force.

<sup>2</sup> Other information includes the Supporting Consolidating and Combining Financial Statements, Required Supplementary Stewardship Information, Required Supplementary Information, and Other Accompanying Information.

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audit opinion. As described above, we are unable to express, and we do not express, an opinion on the referenced financial statements and other information.

## **Summary of Internal Control**

In planning and performing our audit, we considered the Air Force internal control over financial reporting and compliance. We did this to determine our procedures for auditing the financial statements and to comply with Office of Management and Budget guidance, but not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance because previously identified reportable conditions,<sup>3</sup> all of which are material, continue to exist in the following areas.

- Air Force financial management systems,
- Intragovernmental Transactions,
- Fund Balance With Treasury and problem disbursements,
- accounting entries,
- operating materials & supplies,
- government furnished material and contractor acquired material,
- General Property, Plant, & Equipment (PP&E),
- Environmental Liabilities,
- Statement of Net Cost, and
- Statement of Financing.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that misstatements, losses, or noncompliance that are material in relation to the financial statements would be prevented or detected on a timely basis. Our internal control work would not necessarily disclose all material weaknesses. See the Attachment for additional details on material internal control weaknesses.

## **Summary of Compliance with Laws and Regulations**

Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist in the following areas.

- Federal financial management systems requirements,

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<sup>3</sup> Reportable conditions are matters coming to the auditor's attention that, in his or her judgment, should be communicated to management because they represent significant deficiencies in the design or operation of internal control, which could adversely affect the organization's ability to initiate, record, process, and report financial data consistent with the assertions of management in financial statements.

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- generally accepted accounting principles, and
- United States Government Standard General Ledger.

Therefore, we did not determine whether Air Force was in compliance with all applicable laws and regulations related to financial reporting. See the Attachment for additional details on compliance with laws and regulations.

In order for DoD to comply with statutory reporting requirements and applicable financial systems requirements, the Under Secretary of Defense (Comptroller)/Chief Financial Officer is developing the DoD-wide Business Enterprise Architecture. Until the architecture is fully developed and implemented, the Air Force will be unable to fully comply with the statutory reporting requirements.

We caution that other noncompliance may have occurred and not been detected. Further, the results of our limited procedures may not be sufficient for other purposes. Our objective was not to express an opinion on compliance with applicable laws and regulations.

## **Management Responsibility**

Management is responsible for:

- preparing the financial statements in conformity with generally accepted accounting principles,
- establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act (FMFIA) of 1982 are met,
- ensuring that Air Force financial management systems substantially comply with Federal Financial Management Improvement Act (FFMIA) of 1996 requirements, and
- complying with applicable laws and regulations.



Paul J. Granetto, CPA  
Director  
Defense Financial Auditing  
Service

Attachment  
as stated

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# **Reports on Internal Control and Compliance with Laws and Regulations**

## **Internal Control**

Management is responsible for implementing effective internal control and for providing reasonable assurance that accounting data are accumulated, recorded, and reported properly; and that assets are safeguarded. We did not perform tests of internal control over financial reporting for the Air Force, and we did not obtain sufficient evidence to support or express an opinion on internal control. We limited our audit tests because previously identified reportable conditions, all of which are material, continue to exist in the following areas. These material internal control weaknesses significantly impair the ability of Air Force to detect and prevent fraud or theft of assets. A high risk of material misstatements will continue to exist until the internal control deficiencies are corrected.

### **Air Force Financial Management Systems**

- The Air Force had not implemented the U.S. Government Standard General Ledger at the transaction level, therefore, internal control over recording transactions was not sufficient to ensure that all valid transactions were accurately recorded. In addition, all recorded transactions were not accurately reported in the financial statements. For details, see Note 1.D. to the financial statements.
- The financial management systems could not report financial data in compliance with generally accepted accounting principles and OMB Bulletin 01-09, "Form and Content of Agency Financial Statements," September 25, 2001, due to limitations in the financial management processes and systems. For details, see Note 1.A. to the financial statements.
- The Air Force generally records transactions on a cash (budgetary) basis and not on an accrual basis as required by generally accepted accounting principles. The amounts presented in the Consolidated Statement of Net Cost are based on budgetary obligations and disbursements and collection transactions, and are adjusted to record known accruals for major items and known imputed expenses. For details, see Note 1.D. to the financial statements.
- The Air Force does not calculate or recognize an allowance for estimated uncollectible amounts with other Federal agencies. For details, see Note 1.K. to the financial statements.

### **Intragovernmental Transactions**

- Air Force internal control was not sufficient to ensure that all intragovernmental accounts receivable, accounts payable, and revenue transactions were eliminated. For details, see Note 1.G. to the financial statements.
- The Air Force was unable to reconcile intragovernmental accounts receivable or accounts payable, or reconcile intragovernmental revenue balances with its trading partners. For details, see Notes 5, 12, & 19.E. to the financial statements.

## **Fund Balance With Treasury and Problem Disbursements, Collections, & Obligations**

- At the end of FY 2003, the Air Force had \$1.13 billion in problem disbursements and in-transit disbursements that have been reported by a disbursing station to the Department of the Treasury, but have not yet been precisely matched against the specific source obligation. Among other financial statement line items, this condition adversely affects the reliability of the reported value of the Air Force General Funds Balance Sheet line item, Fund Balance with Treasury. For details, see Note 21.B. to the financial statements.
- Internal control was not sufficient to provide obligations incurred and recoveries of prior year obligations in accordance with governing directives. For details, see Note 21.A. to the financial statements.
- Internal control over matching disbursements to respective obligations, and collections to respective receivables, was not sufficient to ensure all disbursements were valid and that accounts receivable and accounts payable balances were accurately stated. For details, see Note 24.B. to the financial statements.

## **Accounting Entries**

The Air Force had not implemented adequate procedures to support and document all journal vouchers in the Air Force General Funds. For details, see Note 1.A. to the financial statements.

## **Operating Material and Supplies**

The Air Force had not recorded operating materials and supplies in conformance with Statement of Federal Financial Accounting Standards No. 3, "Accounting for Inventory and Related Property." Internal control was not sufficient to ensure that operating materials and supplies were correctly reported. For details, see Note 9.B. to the financial statements.

## **Government Furnished Material and Contractor Acquired Material**

Internal control was not sufficient to include all contractor-controlled, Government-furnished material in the financial records. For details, see Note 1.O. and 9.B. to the financial statements.

## **General Property, Plant, & Equipment**

- The Department of Defense has not reported the cost of Military Equipment in accordance with generally accepted accounting standards due to an absence of detailed cost information for Military Equipment acquired over many decades. For details, see Note 10 to the financial statements.
- The Air Force has not implemented adequate controls to ensure real property account balances are accurate. Real property accounts were adjusted without supporting documentation and depreciation expense was not calculated properly.

## **Environmental Liabilities**

Material uncertainties exist related to environmental cleanup liabilities due to incomplete documentation for cleanup costs. For details, see Note 14 to the financial statements.

## **Statement of Net Cost**

The Air Force does not accumulate cost information as required by generally accepted accounting principles. The Air Force identifies costs in the Consolidated Statement of Net Cost based on the major appropriation groups funded by Congress instead of being based on major programs and activities as set forth in Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards for the Federal Government." For details, see Note 1.D. to the financial statements.

## **Statement of Financing**

- The Air Force cannot reconcile budgetary data with proprietary expenses and assets capitalized without making unsupported adjustments to resolve differences. For details, see Note 22 to the financial statements. In addition, the Air Force prepared the Statement of Financing on a combined basis, instead of the consolidated basis required by OMB Bulletin No. 01-09, "Form and Content of Agency Financial Statements."
- Other financing sources reported by the Air Force did not include non-monetary support provided by U.S. Allies for common defense and mutual security. For details, see Note 1.E. to the financial statements.

## **Compliance with Laws and Regulations**

Management is responsible for compliance with existing laws and regulations related to financial reporting. Our work to determine compliance with selected provisions of the applicable laws and regulations was limited because management acknowledged instances of noncompliance, and previously reported instances of noncompliance continue to exist. Therefore, we did not determine whether Air Force was in compliance with selected provisions of all applicable laws and regulations related to financial reporting. Our objective was not to express an opinion on compliance with applicable laws and regulations.

The Air Force is required to comply with the following financial management systems reporting requirements.

The Federal Financial Management Improvement Act of 1996 requires Air Force to establish and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable generally accepted accounting principles, and the United States Government Standard General Ledger at the transaction level. In addition, the Federal Managers' Financial Integrity Act of 1982 requires Air Force to evaluate the systems and to annually report whether those systems are in compliance with applicable requirements. The Chief Financial Officers Act of 1990 requires DoD to prepare a 5-year Financial Management Plan describing activities that DoD will conduct during the next 5 years to improve financial management.

The Air Force acknowledged that many of its critical financial management and feeder systems do not comply substantially with the Federal financial management systems requirements, generally accepted accounting principles, and the U.S. Government Standard General Ledger at the transaction level. In an attempt to comply with statutory reporting requirements and applicable financial systems requirements, DoD is developing a DoD-wide Business Enterprise Architecture. The architecture is intended to provide a "blueprint" of the Department's financial management systems and processes to initiate a comprehensive financial management reform

effort. Until the architecture is fully developed and implemented, Air Force will be unable to fully comply with the statutory reporting requirements. Therefore, we did not perform tests of compliance for these requirements.

## **Audit Disclosures**

Based on audit procedures performed, we obtained a limited understanding of internal control. However, we were unable to obtain sufficient understanding of internal control in order to plan the audit and to determine the nature, timing, and extent of tests to be performed.

The Assistant Secretary of the Air Force (Financial Management and Comptroller) acknowledged to us on June 20, 2003, that the Air Force General Funds financial management systems do not comply substantially with Federal financial management system requirements, generally accepted accounting principles, the U.S. Government Standard General Ledger at the transaction level. These deficiencies in Air Force critical financial feeder systems limited its ability to present information accurately and in conformance with generally accepted accounting principles. As a result, we were unable to obtain adequate evidential matter to form or express an opinion on the financial statements, internal control, and compliance with laws and regulations. Furthermore, we were unable to design the audit to provide reasonable assurance of detecting material misstatements resulting from violations of contracts or grant agreements that have a direct and material effect of financial statement amounts.

In addition, we were unable to conduct sufficient audit follow-up work related to the deficiencies identified in the FY 2002 Air Force financial statement audit. Finally, we did not perform audit tests of Air Force compliance with certain provisions of the Antideficiency Act, Debt Collection Improvement Act, Federal Credit Reform Act, Pay and Allowance System for Civilian Employees, and the Prompt Payment Act.

This report does not include recommendations to correct material control weaknesses and instances of noncompliance because previous audit reports contained recommendations for corrective actions.